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Developments in Farm to Retail Price Spreads for Food Products in 1981

March 1982

Overview

The rise in grocery store food prices slowed to 7.3 percent in 1981, the least in 4 years (figure 1). Food prices also rose less than most other retail prices, helping to slow inflation.

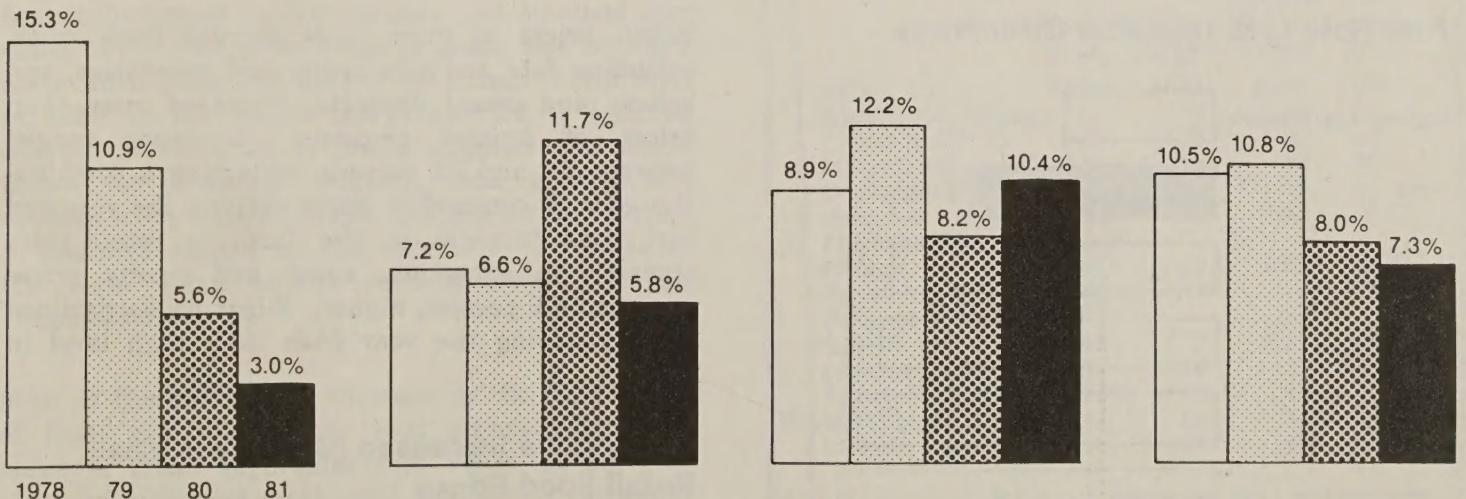
Abundant supplies of farm products, combined with weak demand, held back the pace of 1981 food prices. Farmers harvested bumper crops and expanded most livestock output. Economic activity slowed, dampening consumer demand. These factors caused farm prices to decline during much of 1981. While consumers benefited from easing food prices, many farmers were adversely affected as their costs continued upward.

The farm value of foods sold through grocery stores rose by only 3.0 percent, the smallest increase since 1977. The farm value is the amount of the retail price that pays for farm-produced ingredients. The small rise in farm value accounted for just one-eighth of last year's increase in grocery store food prices of 7.3 percent.

The main contributor to the rise in grocery store food prices was the farm to retail price spread, which accelerated last year, rising by 10.4 percent. The price spread is the charge we pay for food processing and marketing. Rising labor, packaging, and energy costs affected the price spread the most. Higher prices for fish and imported foods also pulled up prices at grocery stores.

Figure 1
Why the Pace of Foodstore Prices Slowed

Increase from
the year before



A slower rise in
the farm value of
domestically grown foods

... as well as in
prices for fish and
imported foods

... despite a faster
increase in the
farm to retail spread

... made the 1981 increase
in foodstore prices the
smallest in 4 years.

During 1981, consumers spent \$285 billion for foods originating on U.S. farms, \$25 billion more than the year before. As in past years, less than a third of the total represented the farm value of these foods, while the rest was needed to pay the marketing bill.

Food Prices Rose Less

All food prices averaged 7.9 percent higher than in 1980, continuing a moderating trend. As in the past, foodstore prices rose less than prices at eating places. Retail food prices at grocery stores rose 7.3 percent compared with 8.0 percent the year before. Food prices at eating places increased 9.0 percent, down from a 9.9-percent rise in 1980.

Food was a moderating force in overall inflation during 1981. A 10.4-percent rise was registered by all consumer prices in the economy (figure 2). This was the third consecutive year and the sixth year out of the last 7 that food prices increased less than nonfood prices.

Domestically produced foods account for about four-fifths of grocers' food sales. Imported foods and fish make up the rest. Retail prices of domestically produced farm foods rose by 7.7 percent. This was a slightly larger increase than for 1980, reflecting the more rapid increase in the farm to retail price spread. Prices of imported foods and fishery pro-

ducts rose by only 5.8 percent, following an increase of nearly 12 percent a year earlier.

Higher charges by the food industry for processing and marketing domestically produced foods caused nearly three-fourths of the 7.3-percent rise in food prices at grocery stores last year. Higher farm prices for these foods caused only about one-eighth of this increase. Higher prices for fish and imported foods were responsible for the remaining eighth of the rise.

Large Meat Supplies Tempered Grocery Price Rise

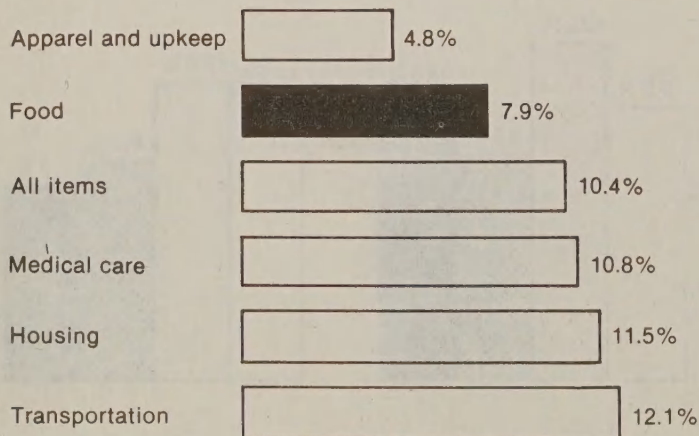
Relatively small price changes for meat and poultry, which account for much of our grocery bill, moderated retail price increases of domestic farm foods last year.

Large meat supplies, particularly for beef, combined with weak demand to keep the rise in meat prices for 1981 to 3.6 percent (figure 3). Retail beef prices averaged only 0.9 percent higher than in 1980, although pork prices rose 9.3 percent. Poultry prices were up 4.1 percent.

Retail prices of milk and other dairy products rose 7.1 percent in 1981, a much smaller rise than in the previous two years. Elimination of a scheduled April dairy price-support increase was influential in slowing the rise in retail dairy prices.

Figure 2

Food Rose Less Than Most Other Prices



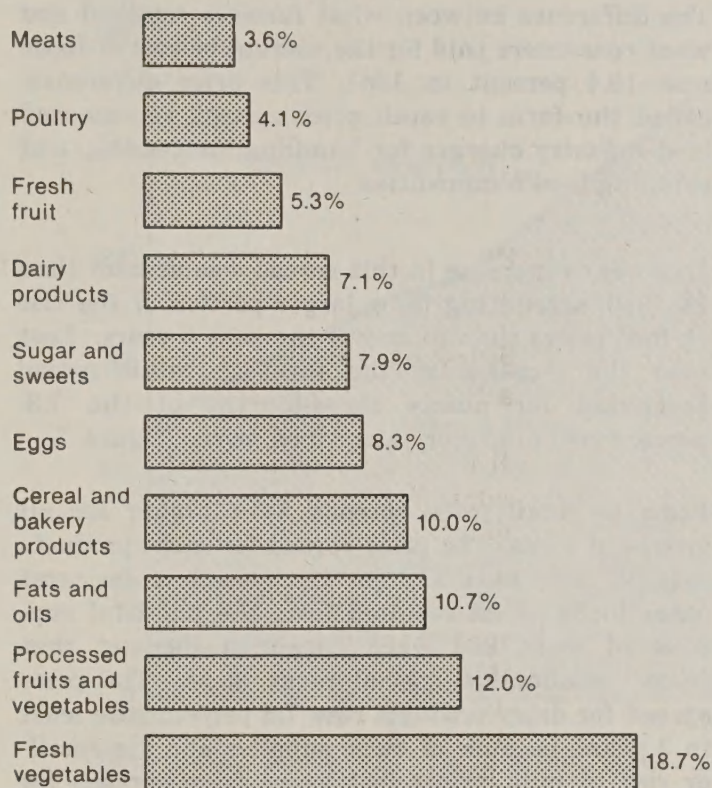
Consumer Price Index, 1981

Retail prices of most foods derived from crops, including fats and oils, fruits and vegetables, and bakery and cereal products, increased more than prices of animal products. Increases ranged between 10 and 12 percent, reflecting a combination of high commodity prices early in the year and the rapid increase in the farm to retail price spread. An exception: sugar and sweets prices averaged 7.9 percent higher. Sugar prices declined sharply during the year from their high level in 1980.

Farm Value Increased Much Less Than Retail Food Prices

The farm value is the amount received by farmers from the retail price of food. USDA determines

Figure 3

All Food Groups Cost More

Change in foodstore prices, 1981.

this value for a fixed list, or "market basket," of foods.

For 1981, the farm value of foods in the market basket increased by 3.0 percent, the smallest rise since 1977. The farm value of foods was actually lower during the last half of 1981 than it had been in 1980. In last year's fourth quarter, it declined sharply in response to larger supplies and lower prices for livestock, poultry, food grains, and oilseeds, coupled with weak demand for agricultural products caused by the recession. By yearend, the farm value was 6 percent lower than in December 1980.

Most of the small 1981 increase in the farm value of foods came from four food groups. The farm value of fresh vegetables rose about 30 percent, that for processed fruits and vegetables increased 19 percent, the farm value of eggs was up 11 percent, and the dairy-products farm value was up nearly 7 percent.

The farm value of meats, which accounts for about four-tenths of the total farm value of the market basket of foods, rose less than 1 percent, held down by lower cattle prices.

Last year, the farm value averaged 36 percent of the price for a market basket of foods, dropping from 37 percent in 1980 and 38 percent in 1979. As seen in figure 4, the percentages varied greatly among foods. The 36-percent farm value share in 1981 was the lowest in two decades. In most years it has averaged 37 to 39 percent. In 1981 abundant food supplies held down farm prices while retail prices rose faster because of processing and marketing charges.

The farm value contributes more to the retail price of eggs, meats, poultry, and dairy products than it does for most other foods. Thus, changes in the farm values of these foods in 1981 affected retail food prices the most. For example, reduced farm values of beef moderated retail meat prices while higher farm prices for eggs played a large part in higher retail prices. Higher milk prices at the

Figure 4

Foodstore Prices, Price Spreads, and Farm Value Shares

	1981 retail price	Farm value	Farm to retail price spread	Farm-value share of retail price
Butter, 1 lb.	\$1.99	\$1.33	\$.66	67%
Eggs, large, 1 doz.	.91	.56	.35	62
Choice beef, 1 lb.	2.39	1.39	1.00	58
Milk, 1/2 gal.	1.12	.62	.50	55
Chicken, 1 lb.	.74	.38	.36	51
Pork, 1 lb.	1.52	.70	.82	46
Frozen orange juice, 12 oz.	1.02	.40	.62	39
Sugar, 1 lb.	.40	.14	.26	35
Potatoes, russet, 10 lb.	3.03	.72	2.31	24
Oranges, Calif., 1 lb.	.39	.08	.31	21
Tomatoes, 1 lb. can	.50	.05	.45	10
White bread, 1 lb.	.52	.05	.47	9*
Lettuce, 1 lb.	.47	.04	.43	9

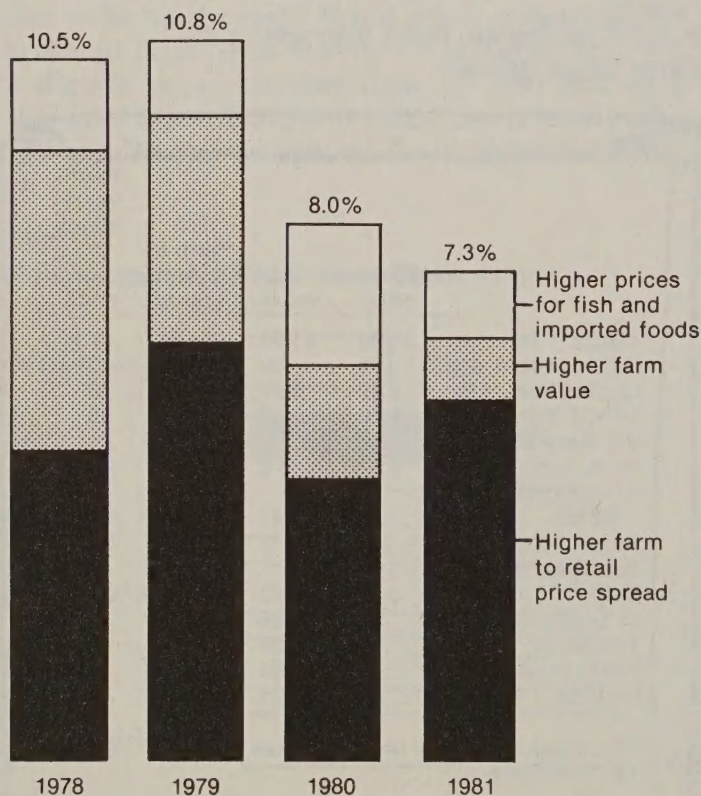
*For wheat only. For all farm ingredients, 10%.
1981 preliminary.

farm caused about half of the rise in retail dairy prices.

The farm value of most foods that come from crops represents a small share of the retail price. Last year, farmers received 29 percent of retail fresh fruit and vegetable prices, 19 percent for processed fruits and vegetables, and 14 percent for bakery and cereal products. Thus, even the large 30-percent increase in farm value of fresh vegetables last year accounted for less than half of the 18.7-percent increase in retail fresh vegetable prices.

While the 3-percent rise in farm value had a moderating effect on food prices, it was not enough to cover rising farm production costs. Prices that farmers paid for the various inputs used in farm production rose by 7.3 percent. This disparity between the payments farmers received for food products and prices they paid for inputs contributed to a decline in farm net cash income last year.

Figure 5
Higher Farm to Retail Price Spreads Have Played a Big Part in Raising Foodstore Prices



Yearly increases in foodstore prices and contributing factors.

Farm to Retail Price Spreads Rose

The difference between what farmers received and what consumers paid for the market basket of foods rose 10.4 percent in 1981. This price difference, called the farm to retail price spread, represented food industry charges for handling, processing, and retailing food commodities.

Last year's increase in this spread was greater than in 1980, accounting for a larger portion of the rise in food prices than in any of the past 5 years. Last year the increase in the farm to retail spread accounted for nearly three-fourths of the 7.3-percent rise in grocery store food prices (figure 5).

Farm to retail price spreads went higher for all groups of foods. The price spread for meat products rose 6.7 percent, a smaller increase than for most other foods. That resulted from the plentiful supplies of meat and weak consumer demand that forced retailers to special meat more. The price spread for dairy products rose 7.6 percent, the least in 3 years, because of large supplies and the smaller rise in milk prices last year. Price spreads for fats and oil products, bakery and cereal products, and processed fruits and vegetables increased 10 to 13 percent. The larger increase for these foods reflects the high degree of processing they undergo and the sharply rising costs of energy and packaging.

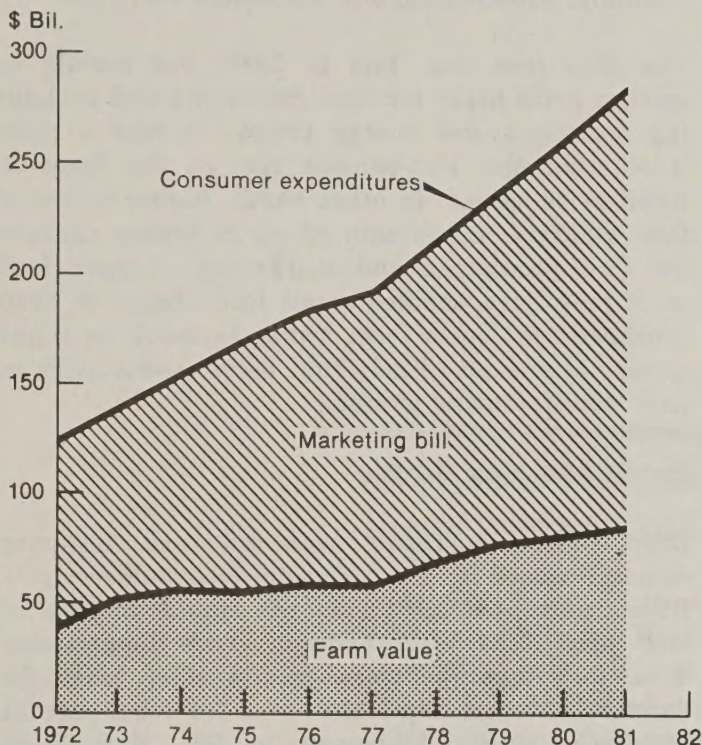
Price spreads for eggs increased only about 3 percent and those for poultry were up by 9 percent. Over time, increases in farm to retail price spreads for these products have been smaller than those for most other foods. Mainly, this is because of economies of scale in this industry as egg and poultry processing operations have grown larger and more efficient.

Consumer Food Expenditures Rose

Consumer expenditures totaled \$285 billion for foods originating on farms last year, \$25 billion, or about 9-1/2 percent, more than in 1980. This amount includes purchases of farm foods both in foodstores and at away-from-home eating places. It is less than total food expenditures since it excludes the value of imported foods and seafoods.

Figure 6

Farm Value and Marketing Bill for Farm Foods



For domestically produced farm foods purchased by civilian consumers both at foodstores and eating places.

1981 preliminary.

Expenditures for domestically produced foods increased more than food prices did, as a rise of about 1 percent in population increased the quantity of food bought. Retail sales adjusted for price changes indicate an increase in the quantity of food bought at grocery stores and also at away-from-home eating places.

About 30 percent of consumer food expenditures went back to farmers, who received about \$85 billion for the foodstuffs equivalent, up \$4 billion from 1980. The remaining \$200 billion of expenditures represented the marketing bill—the total charges received by the food industry for handling, processing, and retailing foodstuffs after they left the farm (figure 6). The marketing bill was up by \$21 billion in 1981 and thus accounted for more than four-fifths of the year's increase in consumer food expenditures.

Over the years, the marketing bill has been the most persistent cause of rising food expenditures.

Since 1976, for example, the marketing bill has added \$74 billion of the \$101 billion increase in consumer expenditures on domestically produced foods, while the farm value has added \$27 billion—mostly in the late seventies.

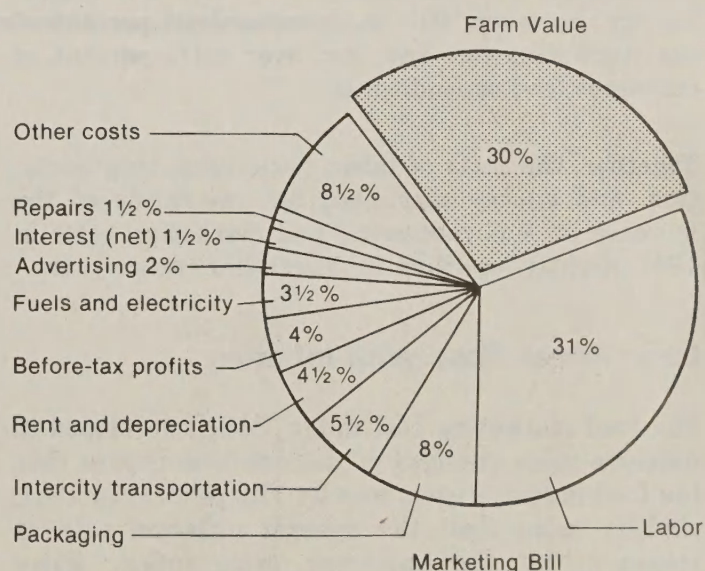
The unrelenting growth in the marketing bill in the past 5 years was due only in small measure to the growing volume of food consumed. It was mainly caused by rising labor costs and by rising prices of other nonfarm inputs bought by the food industry. Prices of these inputs, except energy, generally tend to follow inflation in the economy.

Labor Was The Largest Component Of Marketing Bill

Higher labor costs accounted for slightly over two-fifths of the 1981 increase in the marketing bill. Wages, salaries, and worker benefits were up 11 percent to \$87.9 billion. Labor comprised nearly 44 percent of the food marketing bill and about 31 percent of total consumer spending for farm foods, slightly exceeding the farm value (figure 7).

Figure 7

What Consumer Expenditures for Farm Foods Paid For



Other costs include property taxes and insurance, accounting and professional services, promotion, bad debts, and many miscellaneous items.

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Marketing Bill Components

	\$ billion
Labor	87.9
Packaging materials	23.0
Transportation	15.1
Profit before taxes	12.0
Fuels and electricity	10.3
Other costs	51.5
Total marketing bill	199.8

Higher prices for packaging materials pushed up the bill for food packaging by about 10 percent to \$23 billion, 8 percent of total consumer expenditures for farm foods.

Higher freight rates, particularly on railroads, and a small increase in the volume of food hauled raised transportation costs by 8-1/2 percent. Railroad freight rates for food products were 17 percent higher; truck rates for hauling produce and other foods increased 3 to 5 percent.

The fastest rising component of the marketing bill, although still one of the smallest, was fuels and electricity. With major increases in oil prices and electric rates, the energy bill of food processors, wholesalers, and retailers rose to over \$10 billion. Energy, however, still made up only 5 percent of the marketing bill and just over 3-1/2 percent of consumer food expenditures.

Together, the costs of labor, packaging, transportation, and energy accounted for two-thirds of the increase in food processing and marketing costs in 1981, slightly less than in most other recent years.

Input Prices Rose with Inflation

The food marketing cost index (MCI), developed to measure price changes of the nonfarm inputs that the food industry uses, rose by 11.2 percent in 1981, slightly more than the general inflation rate as measured by the consumer price index. Price increases for inputs used by the food industry were largest for fuels and electricity, railroad transportation services, and interest rates. Labor costs, consisting of hourly earnings and employee benefits,

increased an average of about 10 percent in food retailing, wholesaling, and processing last year.

The MCI rose less than in 1980, due mainly to smaller price hikes for food containers and packaging materials, and energy prices. It rose a little more than the 10.4-percent rise in the farm to retail price spread. In other words, higher prices of food industry inputs showed up in higher charges for food processing and marketing. Larger food sales may have enabled retail food chains to keep overhead unit costs from rising as much as input prices. It was also likely that labor productivity in food manufacturing gained.

Profit Margins Stable

Despite rising operating costs and weak consumer demand caused by the recession, food industry profit margins held up during the first 9 months of last year. Based on Federal Trade Commission data, food manufacturers' profits after taxes for January through September rose from 3.2 percent of sales in 1980 to 3.3 percent in 1981. Returns on stockholders' equity, however, dropped from 13.8 percent to 13.6 percent.

Profits after taxes of food chains averaged 0.79 percent of sales in the first 9 months of 1981 compared with 0.84 a year earlier. First quarter 1981 profit margins of the food chains were unchanged, but second and third-quarter profit margins were slightly lower than in 1980.

Fourth quarter profits are typically higher than for the rest of the year because of holiday buying, and many retailers reported that sales rose more than inflation last year.

Food Industry After-tax Profit Margins

Quarter	Food manufacturers		Retail food chains	
	1980	1981	1980	1981
<i>Percent of sales</i>				
I	3.0	3.0	0.8	0.8
II	3.1	3.4	1.0	.9
III	3.5	3.4	.8	.6
IV	4.0		1.1	

For further information, call
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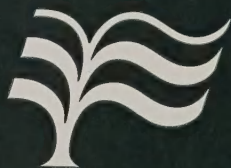
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